

**COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

D.T.E. 04-\_\_

**PREFILED DIRECT TESTIMONY OF DAVID J. KVAPIL**

1    **I.       INTRODUCTION**

2    **Q.       Please state your name and business address.**

3    A.       My name is David J. Kvapil. My business address is One PEI Center, Wilkes-  
4               Barre, Pennsylvania 18711.

5    **Q.       By whom are you employed and in what capacity?**

6    A.       I am the Executive Vice President and Chief Financial Officer at Southern Union  
7               Company ("Southern Union" or the "Company"). In that position, I am  
8               responsible for capital-market financing, debt and cash management, investor  
9               relations, financial accounting and reporting and taxation.

10   **Q.       Please briefly summarize your educational and professional background.**

11   A.       I have a Bachelor of Arts degree from St. Mary's University and a Master of  
12               Science in Accounting from Texas A&M University. I am also a Certified Public  
13               Accountant. I have been employed by Southern Union since 1992 and have held  
14               various positions including Controller, Vice President and Senior Vice President.  
15               I have been the Executive Vice President and Chief Financial Officer since  
16               October 2001.

17   **Q.       Would you please provide a brief description of the Company?**

18   A.       Southern Union is a Delaware corporation that is headquartered in Wilkes-Barre,  
19               Pennsylvania and engaged primarily in the transportation and distribution of  
20               natural gas. Through its Panhandle Energy subsidiary, the Company owns and

1 operates Panhandle Eastern Pipe Line Company, Trunkline Gas Company, Sea  
2 Robin Pipeline Company, Trunkline LNG Company and Southwest Gas Storage  
3 Company. Collectively, these entities operate more than 10,000 miles of  
4 interstate pipelines transporting natural gas from the Gulf of Mexico, South Texas  
5 and the Panhandle regions of Texas and Oklahoma to major U.S. markets in the  
6 Midwest and Great Lakes region. Trunkline LNG, which is located in Lake  
7 Charles, Louisiana, is the nation's largest liquefied natural gas import terminal.  
8 Through its local distribution companies, Missouri Gas Energy, PG Energy and  
9 New England Gas Company, Southern Union also serves nearly one million  
10 natural gas end-user customers in Missouri, Pennsylvania, Massachusetts and  
11 Rhode Island. In Rhode Island and Massachusetts, Southern Union serves  
12 approximately 300,000 customers through its operating division, the New  
13 England Gas Company, with approximately 50,000 customers served in the Fall  
14 River and North Attleboro service areas.

15 **Q. What is the scope of your testimony?**

16 A. I am testifying in support of the Company's petition for approval and  
17 authorization to invest up to \$700 million in CCE Holdings, LLC ("CCE"), a joint  
18 venture between Southern Union and an equity partner, GE Commercial Finance  
19 Energy Financial Services ("GE Energy Finance"). On June 24, 2004, CCE  
20 entered into a Stock Purchase Agreement ("Agreement") with Enron Corp. and its  
21 affiliates (collectively, "Enron") to acquire 100 percent of the equity interests of  
22 CrossCountry Energy LLC ("CrossCountry"). This Agreement is provided

1 herewith as Exhibit SU-2. By order dated June 24, 2004 (the "Order"), the United  
2 States Bankruptcy Court for the Southern District of New York (the "Court")  
3 granted "Stalking Horse" status to the Agreement and established certain bid  
4 procedures for a Court-mandated auction scheduled for 9:00 a.m. on September 1,  
5 2004. This petition is requesting approval for Southern Union to move forward  
6 with its investment in CCE under G.L. c. 164, 17A ("Section 17A") should CCE  
7 be designated by the Court as the winning bidder in the auction process.

8 **Q. Please describe the organization of your testimony.**

9 A. My testimony is organized as follows: (1) Section II describes the CrossCountry  
10 operations and reviews the Court-mandated Section 363 auction process to which  
11 CCE is subject; (2) Section III describes how the proposed investment satisfies  
12 the Department's public interest standard under Section 17A.

13 **II. ACQUIRING THE CROSSCOUNTRY EQUITY INTERESTS FROM**  
14 **ENRON THROUGH THE BANRUPTCY AUCTION PROCESS**

15 **Q. Please describe the operations of CrossCountry.**

16 A. CrossCountry is a holding company headquartered in Houston, Texas that  
17 employees 1,100 people and owns interests in and operates Transwestern Pipeline  
18 Company ("Transwestern"), Citrus Corp. ("Citrus") and Northern Plains Natural  
19 Gas Company ("Northern Plains"). In total, the CrossCountry interstate  
20 distribution system is comprised of approximately 9,700 miles of pipeline and  
21 approximately 8.5 Bcf/day of natural gas capacity, serving customers in four  
22 major geographical regions in 18 states.

1 Transwestern owns and operates 2,400 miles of interstate pipeline transporting  
2 natural gas from the San Juan, Anadarko and Permian Basins to markets in the  
3 Mid-Continent, Texas, Arizona, New Mexico and California. The bi-directional  
4 flow capabilities of the Transwestern facilities provide valuable flexibility to  
5 adapt rapidly to regional demand. Its customers include local distribution  
6 companies, producers, marketers, electric power generators and industrial end-  
7 users.

8 Citrus, which is held 50 percent by CrossCountry and 50 percent by Southern  
9 Natural Gas (an El Paso affiliate) owns Florida Gas Transmission ("FGT"), a  
10 5,000-mile natural gas pipeline extending from south Texas to south Florida with  
11 mainline capacity of 2.1 Bcf/day. FGT has access to diverse natural gas supplies  
12 from the Gulf of Mexico, Texas and Louisiana. FGT serves the rapidly growing  
13 Florida peninsula with over 240 delivery points and delivery connections to more  
14 than 50 natural gas fired electric-generation plants. Its customers include electric  
15 utilities, independent power producers, co-generation facilities, municipal  
16 generators and local distribution companies.

17 Northern Plains is one of the general partners of Northern Border Partners, L.P.,  
18 which holds ownership interests in Northern Border Pipeline Company,  
19 Midwestern Gas Transmission Company, Viking Gas Transmission Company and  
20 Guardian Pipeline, LLC. Northern Border Partners, L.P. operates 2,317 miles of  
21 interstate pipelines with capacity of 4.3 Bcf/day.

1 The interstate pipeline facilities held by CrossCountry operate as “natural gas  
2 companies” as defined in section 2 of the Natural Gas Act (15 U.S.C. § 717) and,  
3 with reference thereto, are subject to all rules and regulations promulgated by the  
4 Federal Energy Regulatory Commission (“FERC”). A map depicting the  
5 locations of the CrossCountry facilities is attached as Exhibit SU-3.

6 **Q. What is the current ownership status of CrossCountry?**

7 A. CrossCountry is a holding company that was formed by Enron in June of 2003.  
8 As previously stated, Enron is currently involved in federal bankruptcy  
9 proceedings and the Court is presiding over the sale of Enron assets to satisfy the  
10 claims of its creditors. Therefore, the sale of the CrossCountry equity interest is  
11 subject to the Court-mandated auction process.

12 **Q. Would you briefly describe the bankruptcy process and how CCE would**  
13 **acquire the equity interests of CrossCountry through this process?**

14 A. Under Chapter 11 of Title 11 of the United States Code (the “Bankruptcy Code”),  
15 a debtor is allowed to dispose of assets in two different ways: (1) under a plan of  
16 reorganization (or liquidation); or (ii) through an asset sale under Section 363 of  
17 the Bankruptcy Code. Under a plan of reorganization, an asset sale cannot be  
18 consummated until numerous statutory requirements for confirmation of the  
19 reorganization plan are satisfied. However, if the debtor or its creditors determine  
20 that the debtor’s assets would yield a greater value in an immediate sale, the  
21 debtor can circumvent the lengthy process of plan confirmation for sale purposes  
22 through the second method, which is an asset sale to a third-party purchaser under

1 Section 363 of the Bankruptcy Code. The Court is currently overseeing the  
2 divestiture of the CrossCountry equity interests in accordance with Section 363.

3 Section 363 is designed to facilitate asset sales and to maximize the proceeds  
4 realized from those sales. For example, Section 363(f) permits a bankruptcy court  
5 to authorize a sale of assets “free and clear of any interest in such property.”  
6 Section 363(m) also seeks to encourage the sale of assets by ensuring the finality  
7 of the court order approving the sale and providing broad protections to  
8 purchasers in the event of an appeal from, or other collateral attack upon, an order  
9 entered by the court approving the debtor’s sale of its assets. The goal of  
10 obtaining the highest or best offer is generally attained by selling the assets  
11 through an auction or other market “test.” Generally, debtors seek to obtain an  
12 initial leading bid (the “Stalking Horse” or “Initial Bidder”) in order to attract  
13 other offers, thereby creating a competitive market for the assets. In return, the  
14 Initial Bidder generally demands various bid protections. Typically, the court  
15 order granting Stalking Horse status includes bidder protections, such as required  
16 bidding increments, deadlines for due diligence and the submission of bids, a  
17 defined auction process, a sale hearing and a requirement that the Stalking  
18 Horse’s form of contract be used as a template for other bids. As noted above,  
19 CCE has been granted Stalking Horse status for purposes of the CrossCountry  
20 auction.

1 In this case, the Order established a 60-day notice period that will conclude on  
2 August 23, 2004. On or before that date, third parties interested participating in  
3 the auction must submit a competing or qualifying bid pursuant to the procedures  
4 defined in the Order. Thereafter, if any competing bids are accepted by the seller  
5 and its committee of unsecured creditors the auction will take place at 9:00 a.m.  
6 on September 1, 2004.

7 The final sale hearing will occur on or about September 9, 2004. At the  
8 conclusion of the sale hearing, the Court will enter an order ("Approval Order")  
9 approving the sale and naming the successful bidder. In the Approval Order, the  
10 Court will find that the price to be paid is fair and that the purchaser is a "good  
11 faith" purchaser so that, upon closing, the purchaser's title to the assets may not  
12 be disturbed absent a finding of fraud. After entry of the Approval Order, the  
13 parties then need to satisfy the conditions of closing outlined in the Agreement  
14 and the Approval Order and proceed to closing.

15 **Q. Why is it important for Southern Union to receive Section 17A approval for**  
16 **the transaction at this juncture?**

17 **A.** Because the Court granted "Stalking Horse" status to CCE, all of the details of  
18 CCE's offer to purchase the CrossCountry equity interests are known to other  
19 prospective bidders. As a regulated public utility, Southern Union will require  
20 various approvals from the state public utility commissions in the jurisdictions in  
21 which it operates in order to move forward and consummate the transaction. In  
22 order to have the ability to compete on a level playing field with other bidders

1 participating in the process, Southern Union is seeking to obtain these approvals  
2 (to the extent possible) prior to August 23, 2004, or at least no later than the close  
3 of the bidding process on August 31, 2004.

4 **Q. If CCE becomes the winning bidder and is approved by the bankruptcy**  
5 **court, what will be the next steps?**

6 A. If CCE is selected by the Court as the winning bidder, CCE will finalize the  
7 conditions of the Agreement and close the transaction as soon as practicable after  
8 all consents and approvals have been obtained, but no later than December 17,  
9 2004. The required waiting period for the transaction under the Hart-Scott-  
10 Rodino Antitrust Improvements Act of 1976, as amended has already expired. In  
11 addition, Southern Union has made application for the respective regulatory  
12 approvals of the Missouri Public Service Commission and the Pennsylvania  
13 Public Utility Commission and has requested that these commissions entertain  
14 approvals (to the extent possible) prior to August 23, 2004, or at least no later  
15 than the close of the bidding process on August 31, 2004.

16 **III. REQUEST FOR APPROVAL TO INVEST FUNDS UNDER SECTION 17A**

17 **Q. Please discuss the reasons that Southern Union is working to accomplish**  
18 **CCE's acquisition of the CrossCountry pipeline facilities.**

19 A. As the Company indicated to the Department in obtaining approval for the  
20 Panhandle Eastern investment, recent events in the energy industry have created  
21 significant growth opportunities for energy companies that remain economically  
22 viable and possess the expertise to manage assets that are now available in the  
23 marketplace. For Southern Union, these opportunities have the potential to



1 produce significant value for both customers and shareholders in terms of  
2 increasing operating synergies, improving customer service, increasing access to  
3 capital markets, increasing operating margins, improving employee relations  
4 improving the overall financial position of the Company and allowing for a more  
5 cost-effective use of internal resources. Moreover, Southern Union has seen  
6 similar value from the Panhandle transaction.

7 The acquisition of the equity interests CrossCountry through the joint venture  
8 with GE Energy Financial will further the Company's long-term strategic plan to  
9 own regulated natural gas assets that will provide stable and predictable cash  
10 flows and provide the opportunity to achieve operating synergies that will benefit  
11 other divisions of the Company.

12 **Q. How will the transaction to acquire CrossCountry be structured and**  
13 **financed?**

14 **A.** As discussed above, the actual details of the transaction and the ultimate  
15 investment arrangement between Southern Union and GE Energy Finance will not  
16 be known until Southern Union is designated as the successful bidder by entry of  
17 an Approval Order by the Court. However, the total investment to be made by  
18 Southern Union to accomplish the purchase of the CrossCountry assets through  
19 CCE will not exceed \$700 million. Southern Union will undertake an equity  
20 issuance to raise all or part of the capital needed to fund its portion of the  
21 investment. The remainder of the purchase price will be funded through a  
22 combination of: (1) investment by GE Energy Finance; (2) the assumption of

1 existing CrossCountry debt totaling approximately \$461 million, and (3) a debt  
2 issuance by CCE. For Southern Union, both the existing debt that will be  
3 assumed through the transaction and the new debt to be issued by CCE will be  
4 non-recourse debt, which means that the debt is not in anyway guaranteed by  
5 Southern Union.

6 **Q. Please describe the operations of GE Commercial Finance.**

7 A. GE Energy Finance is a sub-unit of GE Commercial Finance, a unit of the  
8 General Electric Company. GE Commercial Finance offers lending products,  
9 growth capital, revolving lines of credit, equipment leasing, cash flow programs,  
10 asset financing and other financing products to a broad range of commercial  
11 customers. The industries served include healthcare, manufacturing, fleet  
12 management, communications, construction, aviation, motor vehicle fleets,  
13 infrastructure and equipment, as well as the energy sector.

14 **Q. Will the operation of CCE have any negative effect on the Company's ability**  
15 **to manage its local gas distribution activities?**

16 A. For several reasons, the CCE operations would have no negative effect on the  
17 Company's ability to manage its local gas distribution activities. First, as  
18 interstate-pipeline facilities, the CCE operations would be fully regulated by  
19 FERC as they have been in the past when operated by Enron. In that regard, the  
20 CrossCountry facilities have a record of safe and reliable operation. In addition,  
21 Southern Union will manage the activities of CCE as a subsidiary with designated

1 personnel and resources just as it has been operating Panhandle Eastern and  
2 similar to the way it operates its local gas distribution facilities.

3 Over the past three years, Southern Union has decentralized its operations and  
4 established local business units with strong management teams that function  
5 independently, except with respect to certain financial and corporate-management  
6 activities that are performed at the corporate level. Thus, in terms of internal  
7 resources, Southern Union is simply acquiring additional interstate pipeline  
8 facilities to operate in conjunction with the facilities acquired through the  
9 Panhandle Eastern transaction, and therefore, the transaction would have no  
10 negative effect on customers of the distribution companies operated by Southern  
11 Union. In fact, customers are fully protected from any possible negative  
12 ramifications because their rates will not change as a result of the Department's  
13 approval of the investment and, in the future, cannot change without Department  
14 approval. In addition, the quality of service provided to customers in  
15 Massachusetts is tracked and monitored through a service-quality program that  
16 subjects the Company to significant financial penalties in the event of declining  
17 performance.

18 At the same time, the addition of the CrossCountry operations is expected to  
19 enhance the financial operations of the Company, which would benefit the  
20 customers of the Company's distribution companies in terms of access to capital  
21 markets and the Company's cost of capital. Moreover, as a result of the addition

1 of the CrossCountry operations, Southern Union will have the opportunity to  
2 achieve financial and operating synergies that will help to control and/or reduce  
3 costs for the overall system. These potential synergies would not be available to  
4 customers in the absence of the CrossCountry arrangement. As a result, Southern  
5 Union will be better positioned to continue to maintain stable rates for  
6 Massachusetts customers on a going-forward basis. For these reasons, customers  
7 bear no risk and can only benefit from the proposed investment.

8 **Q. As part of the transaction, will the Company make any financial guarantees**  
9 **on behalf of any entity?**

10 A. No. The Company does not anticipate the need to make any financial guarantees  
11 over and above its principal investment in CCE that would require approval by  
12 the Department under Section 17A.

13 **Q. What is the anticipated closing date for the purchase of CrossCountry?**

14 A. As discussed above, Southern Union is seeking approval from the Department in  
15 this filing to invest up to \$700 million as part of a joint venture with GE Energy  
16 Finance in order to acquire 100 percent of the equity interests of CrossCountry.  
17 Should CCE become the winning bidder in the auction process, the details of the  
18 actual transaction will be known and the Company would move forward with its  
19 financing arrangements with the objective of completing the transaction no later  
20 than December 17, 2004.

21 **Q. Does this complete your testimony?**

22 A. Yes, it does.